Goodbye to fiscal consolidation

The Narendra Modi government has taken pride in having restored the economy to the path of fiscal consolidation. The fiscal deficit target for 2017-18 had been set at 3.2% of GDP for 2017-18 and 3.0% for 2018-19. The Budget for 2018-19 puts paid to these objectives for now. The fiscal deficit for 2017-18 has ended up at 3.5%. For 2018-19, the government has set a target of 3.3%. The fiscal deficit target of 3% of GDP has now been pushed to 2020-21.

Missed targets

Revenue receipts in 2017-18 have grown faster than anticipated (although non-tax revenues have fallen short of target). We can compare the revised estimate for 2017-18 with the actual for 2016-17 and the Budget estimate for 2017-18 with the revised estimate for 2016-17. Tax revenues were higher than anticipated (15% compared to 13%).

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Capital receipts are expected to exceed the budgetary estimate thanks to record disinvestment revenues of 100,000 crore (27,500 crore higher than targeted). On the revenue side, the government could not have expected better.

Budget 2018: Jaitley announces Rs 1.48 lakh crore as railway capital expenditure

It is the expenditure side that has given way. Revenue expenditure grew by 15% compared to the Budget estimate of 6%. An increase in establishment expenditure accounts for more than 40% of the increase in revenue expenditure. Capital expenditure ended up lower than in the previous year by 3.9%. In the Budget for 2017-18, capital expenditure had been set 10.7% higher. This was flagged as one of the great accomplishments of last year's Budget and it was expected to boost GDP growth.

The fiscal slippage in 2017-18, therefore, cannot be ascribed to a lower than projected nominal growth (around 9.5% compared to 11.5%). Expenditure has got out of control or was under-estimated in last year's Budget. Moreover, revenue, not capital, expenditure is the villain. The revenue deficit for 2017-18 is 2.6% of GDP, way above the Budget estimate of 1.9% of GDP.

Projections for new fiscal

What do we make of the projections for 2018-19? The Budget projects an increase in tax revenues of 16.6% compared to 15.3% in the previous year, which appears achievable. Total expenditure is expected to grow by 10.1% compared to 12.3%, which could turn out to be an under estimate. Capital expenditure has been set 9.9% higher which is modest given that there had been a decline in the previous year.

Growth in public investment is tepid. There are no big tax giveaways either in the Budget. Clearly, fiscal policy is not being used to stimulate growth. With inflation running at 5%, the scope for monetary easing too is limited. The government is leaving it to market forces to drive growth in the coming year.

The Economic Survey 2017-18

Will it work? In 2017-18, the Economic Survey argues, growth was dampened by a combination of factors: high real interest rates, disruption caused by demonetisation and the goods and services tax (GST), the twin balance sheet problem and high oil prices. The disruption caused by demonetisation and GST is out of the way. The Survey hopes that the bankruptcy process put in place will resolve the twin balance sheet problem — we have to see how the process plays out. As inflation edges up, we could see monetary tightening. With oil prices projected to be \$10-\$12 higher in the coming year, growth could be adversely impacted by 0.3%.

One source of anxiety is overheated asset markets the world over. In India too, equity valuations have been extremely stretched. The Budget has introduced a tax of 10% on long-term capital gains while retaining the securities transactions tax. The reaction of the market thus far has been muted.

However, should asset prices fall elsewhere, we could see the same happening here. Consumption and investment would fall as a result. The monetary authorities may have to raise interest rates in order to stem capital outflows. In such a situation, fiscal expansion would be required to sustain growth. This would clearly upset the budgetary arithmetic. The budgetary projections for 2018-19 thus hinge critically on nothing going wrong with the equity markets and investors shrugging off the tax on long-term capital gains.

On the positive side, the ratio of gross tax revenues to GDP, which had been stagnating at around 10% since 2008, has risen to 11.6% in 2017-18 and is projected to rise further to 12.1% in 2018-19, 12.4% in 2019-20 and 12.7% in 2020-21. This shows that demonetisation and GST are beginning to pay off by widening the tax base and increasing the buoyancy of tax revenues. There is reason to be optimistic, therefore, about the medium-term outlook for government finances whatever the problems in the next year or two.

Rural foray

Many analysts had expected a populist budget in the run-up to elections. Typically, this meant tax concessions to the salaried classes and measures such as loan waivers. These are absent in Finance Minister Arun Jaitley's Budget. The Budget brings back the standard deduction for tax payers, of 40,000. But this is in lieu of transport and medical expenses and is also offset partially by an increase in cess from 3% to 4%. There is little else to cheer for the middle class.

However, the Budget has tried to reach out to the rural constituency and to the poor through a number of measures. The most notable, perhaps, is the promise of a minimum support price (MSP) for all crops of 50% above the cost of production. Rural distress is pervasive and the fall in the price of groundnut, for example, in Saurashtra appears to have cost the Bharatiya Janata Party (BJP) dearly in the Gujarat elections. The proposal on MSPs is thus shrewdly timed, though it would mean higher prices for consumers.

Budget 2018: Health

The Budget proposes a health insurance scheme that will cover 10 crore poor families with an insurance cover of 5 lakh each. Since such a cover would mean an annual premium of at least 10,000, it is doubtful that it is backed by actual outlays in the Budget. Moreover, basic health care must be provided through government hospitals and not through insurance that pays for care at private hospitals. This is a disturbing sign that we are going down the American route to health care instead of, say, the Canadian route.

The Budget also includes several measures for micro, small and medium enterprises (MSMEs). There is a target of 3 lakh crore for lending under the MUDRA scheme. The government will pay 12% towards the Employee Provident Fund for new employees in all sectors for the next three years. A lower corporate tax of 25%, hitherto applicable to enterprises with a turnover of 50 crore, is now applicable to companies with a turnover of up to 250 crore.

It is clear that a return to a high growth trajectory of 8% is unlikely before the 2019 election. The BJP seems to have reckoned it has the urban middle class with it regardless. It is the rural constituency that needs focus. The Budget for 2018-19 has expenditure items planned accordingly while ensuring that the fiscal deficit stays within reasonable bounds.

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